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Launch
Resources Inc.

2003
ANNUAL REPORT

Corporate Profile

Launch Resources Inc. ("Launch" or the "Corporation") is a public company engaged in the exploration, development and production of oil and gas in Western Canada. The common shares trade on the TSX Venture Exchange under the symbol "LAU". Pursuant to a special resolution passed by shareholders August 29, 2003, the Corporation has changed its name from Kicking Horse Resources Ltd. to Launch Resources Inc. Launch is a reporting issuer in the provinces of Ontario, Saskatchewan, Alberta, British Columbia, Manitoba and Quebec.

The Corporation has spent most of the previous year effecting a restructuring of its management, operations and regulatory status. Cease trade orders against the Corporation were revoked in October 2003 following the filing by the Corporation of its continuous disclosure materials.

Launch will maintain its focus to continue exploitation of its core properties with the addition of low risk exploration in surrounding areas. Acquisition will remain key to growth, but as the Corporation gains critical mass in 2004, internally generated exploration prospects will be further enhanced.

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Corporate Highlights

Year ended ended December 31	2003	2002	% Change
FINANCIAL ($ except per share amount)			
Oil and gas revenue	5,786,791	11,033,848	-47%
Cash flow from operations	1,459,048	2,500,638	-42%
- per share			
Loss for the year	7,815,660	2,627,981	-197%
- per share			
Capital expenditures, net	1,584,840	1,003,805	+58%
Debt, net of working capital (deficiency)	(9,579,022)	(15,909,154)	+40%
Total assets	22,170,997	39,468,502	-44%
Shareholders' equity	526,012	39,468,502	-99%
Shares outstanding			
Basic	56,181,306	46,457,300	+21%
Weighted average shares			
Basic	46,941,551	46,454,383	+1%
OPERATIONAL			
Daily Volumes			
Oil and NGL sales (bbl/d)	145	264	-45%
Natural gas (mcf/d)	1,609	5,275	-69%
Total boed (6:1)	413	1,143	-64%
Prices			
Oil and NGL ($/bbl)	$36.81	$32.96	+12%
Natural gas ($/mcf)	$5.93	$3.93	+51%
Statistics			
Operating netback ($/boe)	$21.78	$14.58	+49%
Operating expenses ($/boe)	$9.98	$7.34	+36%
General and administrative ($/boe)	$10.54	$6.85	+40%
Royalties as a % of sales	17%	17%	0%

(1) Net loss and cash flow are presented after non-controlling interest.

(2) Cash flow from operations is a non-GAAP measurement. Management uses cash flow from operations (before changes in non-cash working capital) to analyze operating performance and leverage. Cash flow from operations as presented does not have any standardized meaning prescribed by Canadian GAAP and therefore it may not be comparable with the calculation of similar measures for other entities. Cash flow as presented is not intended to represent operating cash flow or operating profits for the period nor should it be viewed as an alternative to cash flow from operating activities, net earnings or other measures of financial performance calculated in accordance with Canadian GAAP. All references to cash flow from operations throughout this report are based on cash flow before changes in non-cash working capital.

Message to Shareholders

Rebuilding

When I first wrote to you, our shareholders, in May 2003, I described to you a Corporation beset with adversity which had suffered substantial losses on an acquisition, had suffered setbacks in production and had been forced to sell assets.

I am now pleased to write to advise you that we have completed key steps in our mission to restructure and revitalize the Corporation. Since January 2003, the following has been accomplished:

- All filings and financial statements were prepared and filed;
- The provincial Securities Commissions Cease Trade Orders were rescinded on October 27, 2003;
- An Annual General Meeting of Shareholders was held on August 29, 2003. The shareholders approved a new Board, accepted financial statements and auditors, approved a 5:1 stock consolidation;
- The shares of the Corporation were listed on the TSX Venture Exchange on March 8, 2004;
- The Corporation disposed of minor property interests for proceeds of $5.2 million and repaid debt;
- The Corporation negotiated an increase in subordinated debt, first to $2.5 million and subsequent to year end to $6.0 million;
- The Corporation raised equity and flow-through financing of $1.9 million;
- Using the above financing, a total of nine wells were drilled at our properties in St. Anne and Retlaw, resulting in five gas wells, three oil wells and one dry hole; and
- The above wells discovered one new oil pool and four gas pools, adding 817,000 boe to our reserve base.

On the negative side, the Corporation reclassified significant reserves, according the required change in policy from National Policy 2-B to National Instrument 51-101. The more rigorous test of reserve recovery required a net downward revision of 1,331,000 boe. Additionally, 855,000 boe were sold in January 2003. With discoveries of 817,000 boe, the Corporation had a net negative revision of 1,521,000 boe.

Additionally, one of the Corporation's primary gas wells at Retlaw declined at a much higher rate than expected and forced us to re-evaluate and write down those reserves. We have conducted a remedial program on the reservoir, but require additional time to evaluate its success.

OPERATIONS

The Corporation's objective in 2003 was to consolidate the existing asset base (January 2003) and to maximize the productivity of the remaining assets. Starting in mid year, a capital program was commenced to undertake development at St. Anne and Retlaw. The program was undertaken to meet our flow-through commitments.

The program consisted of nine wells. The initial drilling comprised of two wells drilled in June. A gas well at St. Anne tested 1.5 mcf/d from the Notikewin Formation, was tied-in to existing facilities in late September and is currently producing at 1.2 mmcf/d (net 600 mcf/d). The second well was completed, and produced gas for a one month period and then produced oil and water. An artificial lift was installed in November. Due to the high water cut, the well is currently producing at a low rate but we believe that a minor workover would reduce the water production.

A drilling program was commenced in December consisting of an additional two wells at St. Anne and five wells at Retlaw. One well was dry and abandoned and the remaining six wells were cased as potential oil and gas wells. At St. Anne two wells were cased, one as a potential Belly River gas well and the second as a Nordegg oil well. Both wells are waiting for additional completion or tie-in.

Of the four remaining wells at Retlaw, a Glauconite oil well has been completed and placed on limited production, pending water disposal facilities. Two gas wells have been tied-in to date and are now producing. The fourth well, a gas well, was damaged during completion and we are evaluating alternatives for producing this zone.

The Corporation experienced significant production decline during the year. A total of 300 boed was sold in January. Accelerated production decline at Retlaw accounted for an additional decline of 213 boe. This, plus normal decline, was somewhat offset by the addition of 100 boed in 2003 and subsequent tie-in of an additional 100 boed. Future additions are expected in 2004.

The winter program was conducted in late November and December and consisted of two wells drilled in St. Anne and five wells drilled at Retlaw. The two St. Anne wells were both cased, one a Nordegg oil well and the second a potential Belly River gas well. Both wells are suspended pending economic evaluation.

The Retlaw program resulted in three gas wells and one oil well. Three wells are now tied-in and producing, the fourth is waiting on a workover and tie-in. We believe that the well was damaged during completion and we are evaluating remedial options.

The fifth well at Retlaw was dry and abandoned.

Production for the Corporation was significantly reduced during the year due to the sale of non-core properties and the accelerated decline of a well at Retlaw. The Corporation's production declined from 495 boed at year-end 2002 to a low of 322 boed. The drilling activities during the year increased production to 380 boed at year-end.

FINANCIAL

The financial restructuring is proceeding as planned. The reduction in bank debt, the resolution of the flow-through liability and the equity financing accomplished in December have all contributed to improving the Corporation's financial picture. The recent tie-in of production has increased cash flow, as has a reduction in the bank principal payment to $150,000 per month. The Corporation anticipates a reduction in its outstanding trade creditor balances over time.

In addition to increased production and decreased bank cost, the recent strength in oil and gas prices have benefited the Corporation's revenues. Recent oil prices of $54.00/barrel and gas prices exceeding $7.00/mcf have resulted in increased cash flow. It is our belief that prices will continue to be high due to high world demand for oil and gas prices and will be driven by short supply in North America. The Corporation is not considering hedging in this market but, should a downward price trend develop, we would consider some hedge protection.

FUTURE ACTIVITY

The Corporation is pursuing a three phase approach.

- Continue debt reduction through cash flow.
- Maximize production and reserve values.
- Look for expansion/exploration opportunities in its core areas of Retlaw, St. Anne and Watelet.

The Corporation is obligated to spend $1.7 million on flow-through capital activities this year. We have currently spent $450,956 of this. The remainder will be spent on selected capital projects later this year.

In conclusion, we believe that the Corporation's turnaround and restructuring is almost complete. We expect that the balance of the year will prove very productive for the Corporation.

John L. Burlington, M.Sc.
President and Chief Executive Officer
May 21, 2004

Operations and Exploration Review

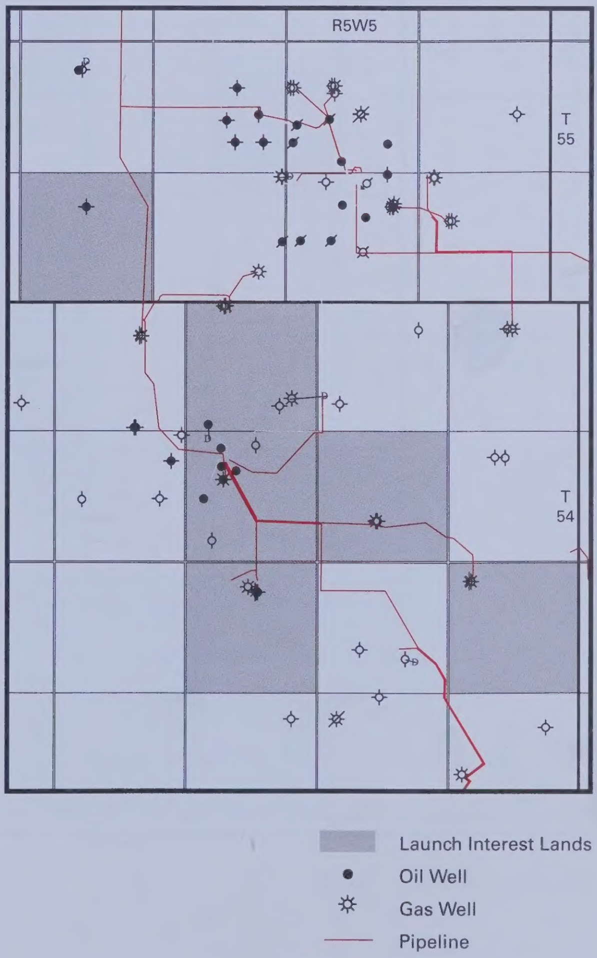
Core Areas

CENTRAL ALBERTA

St. Anne

Further development of the St. Anne prospect occurred in 2003 with the drilling of four well locations identified during the interpretation of the 2D and 3D seismic shot in 2002. Following successful acquisition of an increase in land interest from 12.5 percent to 50 percent in one of the prospects, a successful title-preserving well was drilled and placed on production. Launch now holds a 50 percent working interest in this non-operated property comprised of six contiguous sections of land (1,554 hectares). Productive horizons include oil from the Pekisko Formation and gas from the Nordegg, Notikewin, Glauconite and Belly River Formations.

Results from the 2003 drilling program reconfirmed the necessity of having good seismic coverage and interpretation in order to optimize the targeting of drilling locations. Two wells were drilled targeting gas in the Notikewin Formation; of these only one was an economic success. However, the second well was cased for Belly River gas evaluation and production. The remaining two wells drilled during 2003 were cased for Pekisko production.

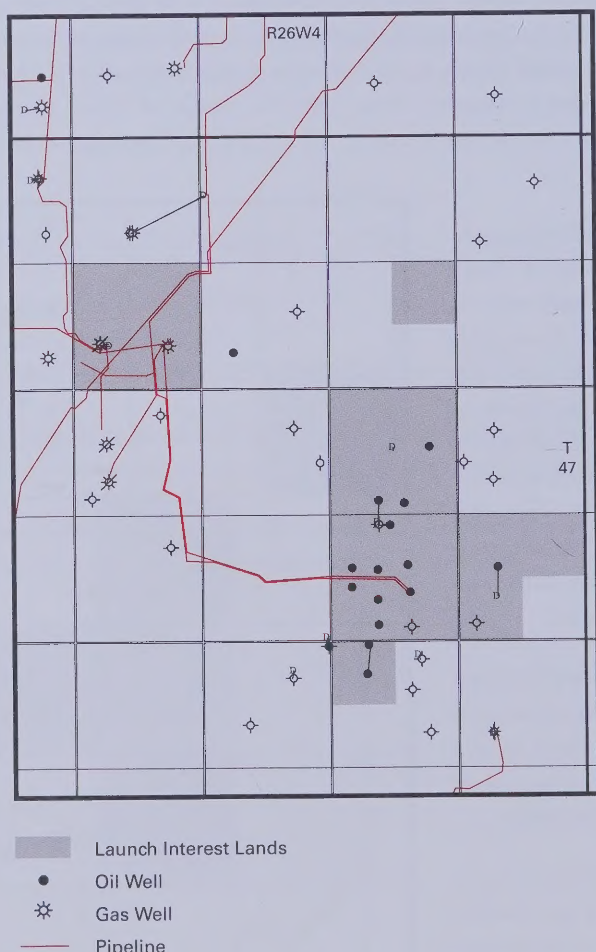


Launch exited 2003 with a 50 percent interest in eight oil wells and in seven gas wells, of which two had not yet been tied in as two wells were drilled, tested and rig released in late December.

The St. Anne property continues to be an attractive exploration and development area due to the multi-zone target potential and the moderate drilling depths. Land availability is decreasing due to the interest and activity of competing companies and the amount of land that was posted and sold during 2003.

CENTRAL ALBERTA – WATELET

Launch Resources has retained its interests in over 1,200 hectares of land in the Watelet area. Working interests range from 26 to 55 percent in the 13 wells currently on production. Production from the 12 producing oil wells in the Watelet Ellerslie A Pool was 110 bopd gross and 55 bopd net. The Belly River gas well generated an additional 420 mcf/d gross and 210 mcf/d net to Launch. Net exit production for 2003 was 58 bopd and 153 mcf/d. Several additional drilling opportunities have been identified on Launch interest lands. Plans for 2004 on this non-operated acreage will be aimed at maintaining stable production volumes and optimizing the recovery of the oil reserves.



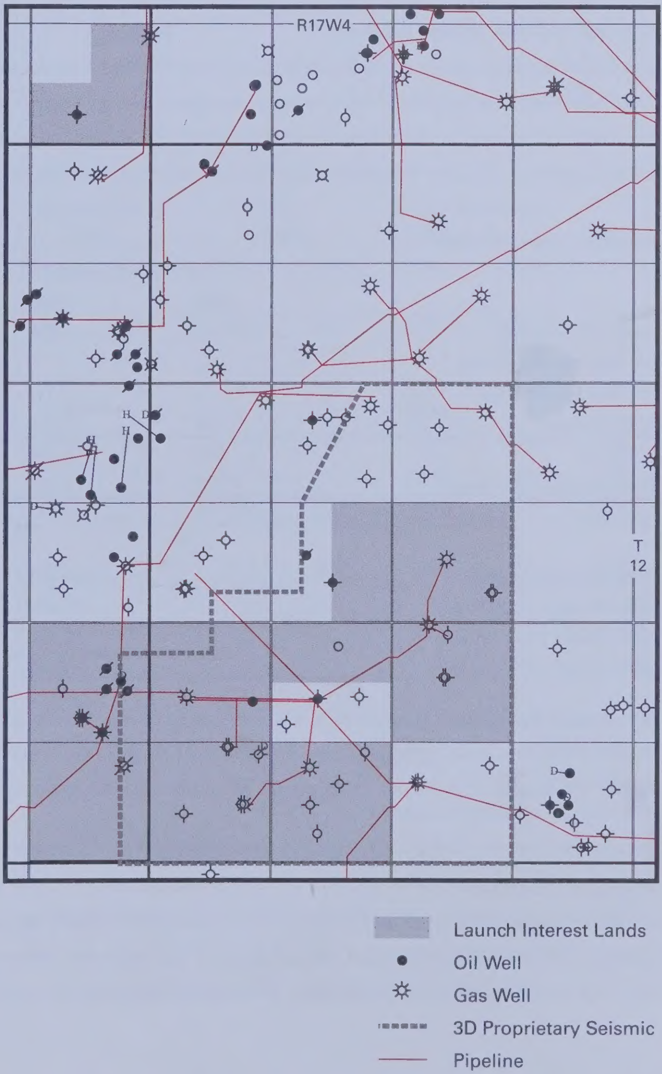
SOUTHERN ALBERTA – RETLAW

During 2003, this area continued to be the primary core property for Launch due to operatorship, the significant and strategic land position and the comprehensive, proprietary 3D seismic coverage. Prospective stacked horizons in this area include oil and gas producing Lower Mannville sands, gas productive Upper Mannville channels of varying ages, Second White Specks gas, as well as other potential hydrocarbon bearing formations.

A total of five wells (4.03 net) were drilled in this area during the second half of the year, resulting in significant total reserve additions. Four wells were cased for production; one well was drilled and abandoned.

The Retlaw area was the Corporation's main area of activity during Q4 2003. Launch operated and drilled four wells, resulting in two gas wells, one oil well and one dry hole. They were drilled, evaluated and cased before year end, allowing them to satisfy flow-through expenditure requirements. It was not possible to get all of these wells tied-in prior to year end however, so their effect on production increases will not be realized until early 2004. Reserve additions for the Q4 2003 wells totaled 2.3 net bcf to the Corporation.

Retlaw will continue to be a main focus area during 2004. Additional opportunities for relatively low risk exploration and exploitation have been identified. This follows the corporate mandate of growth through internally generated prospects in core properties. The Corporation holds interests in 1,036 gross (543.9 net) ha of land as of December 31, 2003. Launch, as operator, has managed to effectively reduce drilling costs in this area. Operating costs will also be reduced by Q2 2004 with a solution to the disposal of water associated with production, thus allowing the Corporation to increase its production rates significantly.



PRODUCTION

Combined natural gas, oil and natural gas liquids production for the year ended December 31, 2003 decreased by 64% when compared to 2002. The Corporation's daily production averaged 413 boed for the year ended December 31, 2003, down from 1,143 boed during the corresponding period in 2002. The decrease is attributed to property disposition during the first quarter of 2003 as well as normal decline in production. The Corporation's average production split for the year was 65% gas and 35% oil and NGLs.

During the year Launch has drilled or participated in nine new wells, four at St. Anne (two net) and five at Retlaw. Increase in production from the current level is anticipated by the end of second quarter of 2004, due to tie-in of the newly drilled wells, and workover and reactivation of existing wells. Total estimated production once all wells are tied-in is approximately 875 boed.

RESERVES

Volumes and Net Present Value

The following table shows the Corporation's net reserves and forecast net revenues as evaluated by Chapman Petroleum Engineering Ltd., independent oil and gas reservoir engineers, at December 31, 2003. The future net revenue numbers presented here and throughout the statement, whether calculated without discount or using a discount rate, are estimated values and do not represent fair market value.

Reserve Reconciliation

	Oil and NGL (mstb)		Gas (mmcf)	
	2003	2002	2003	2002
Proved Producing	176	536	1,597	7,327
Proved Non-Producing	–	–	1,281	–
Proved Undeveloped	–	77	–	280
Total Proved	176	613	2,872	7,607
Probable	397	495	2,327	3,536
Total Proved + Probable	573	1,108	5,198	11,143
Possible	72	–	1,164	–

Forecast Net Revenue	DCF 0%	DCF 10%	DCF 15%
2002 Proved + Probable (2)	45,897	29,106	24,857
2002 Proved + ½ Probable (3)	37,403	24,493	21,167
2003 Proved + Probable (4)	19,216	13,513	11,835

(1) Corporation's interests, before royalties

(2) Unrisked reserves

(3) Risked at 50%

(4) Risked at 50% and NI 51-101 compliance

Pricing Assumptions

Chapman Engineering used its January 1, 2004 price and market forecasts in preparing estimated future net revenues. These forecasts are based on an informed interpretation of currently available data and information from sources which include numerous government agencies, industry publications, Canadian oil refiners

and natural gas marketers. While these forecasts are considered reasonable at the time of preparation, users of these forecasts should understand the inherent high uncertainty in forecasting any commodity or market. These forecasts are revised periodically by Chapman as market, economic and political conditions change. Future revisions may be significant. The following forecasts are adjusted for any reserve quality adjustments, transportation charges and varying natural gas contracts specific to the Corporation's reserves.

Pricing Forecast

2003 forecast net revenue for the above was determined using Chapman's Pricing Forecast, as follows:

Year	Oil WTI ($US/bbl)	Oil Edmonton Par ($Cdn/bbl)	Natural Gas AECO Spot ($Cdn/bbl)
2004	31.25	41.17	5.75
2005	29.25	38.50	5.25
2006	28.25	37.17	5.00
2007	27.00	35.50	5.00
2008	27.41	36.03	5.00
2009	27.82	36.57	5.00

Reserve Reconciliation

	Crude Oil (mstb)		Natural Gas (bcf)		NGL (mstb)		Barrel Equivalent Mboe (6:1)		Mboe
	Proved	Probable	Proved	Probable	Proved	Probable	Proved	Probable	Total
Jan 1/03									
Reserves	513.0	466.7	7.6	3.5	99.0	28.0	1,879	1,078	2,957
Revision*	–	(233.4)	–	(1.75)	–	(14.0)	–	(539)	(539)
P+1/2P	513.0	233.4	7.6	1.75	99.0	14.0	1,879	539	2,418
Production	(47.3)	–	(0.6)	–	(5.7)	–	(151)	–	(151)
Additions	–	157.5	3.2	0.75	7.1	–	537	280	817
Disposition	(133.0)	(0.9)	(3.9)	(0.2)	(42.0)	–	(818)	(37)	(855)
Revisions	(174.8)	–	(3.5)	–	(40.4)	(7.0)	(792)	–	(792)
Jan 1/04									
Reserves	158.0	390.0	2.9	2.3	18.0	7.0	655	782	1,436

* The initial reserve revision is attributed to changes in reserves definitions between National Policy 2B (2003) and NP 51-101 (2004). Chapman feels that, for comparative purposes, P+P1/2P (2003) should be compared to P+P in 2004.

The significant negative revisions were due to unanticipated declines in reserves at key wells in Watelet and St. Anne. A significant decline at a Retlaw gas well also occurred. A remedial program was undertaken on the reservoir, but it will be several months before the results of the program can be determined.

Note: The previous evaluation was prepared in accordance with National Policy 2-B reserves definitions. Under that policy, probable reserves were required to be adjusted by a factor to account for risk associated with their recovery. Launch previously applied a risk factor of 50% in reporting its probable reserves. Under new NI 51-101 reserves definitions, estimates are prepared such that the full proved plus probable reserves versus previous proved plus risk adjusted probable ("Established") reserves reported by Launch.

Management's Discussion and Analysis

The following discussion and analysis ("MD&A") is management's assessment of Launch Resources Inc.'s ("Launch") historical financial and reporting results in Canadian dollars for the years ended December 31, 2003 and December 31, 2002 and should be read in conjunction with the audited financial statements and the notes related thereto. The reader is advised that historical results are not necessarily indicative of future performance. Management uses estimates where necessary to ensure that the information presented is full and complete.

This financial review contains the term cash flow from operations, which is a term no longer used in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Corporation's performance. The Corporation presents cash flow from operations per share whereby per share amounts are calculated consistent with the calculation of earnings per share.

This report provides, in tabular form, the comparative operating and financial results of Launch Resources Inc. for the years ended December 2003 and 2002.

This MD&A contains forward-looking or outlook information which reflects management's expectations regarding the Corporation's future growth, results of operations, performance and business prospects and opportunities. The use of words such as "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe", "outlook", "forecast", and similar expressions are intended to identify forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in these forward-looking statements. Although management believes the expectations reflected in these forward-looking statements are reasonable, there can be no assurances that the actual result will be consistent with forward-looking statements. Readers should not put undue reliance on forward-looking information. These statements are made as of the date hereof and management assumes no obligation to update or revise these statements to reflect new events or circumstances.

DETAILED REVIEW OF FINANCIAL RESULTS

Net Earnings and Cash Flow from Operations

	2003	2002
Net loss	(7,815,660)	(2,627,981)
per share	(0.14)	(0.06)
Cash flow	1,459,048	2,500,638
per share	0.03	0.05

Launch generated cash flow from operations of $1,459,048 for the twelve months ended December 31, 2003, down 42% from the $2,500,638 produced in the same period of 2002. The decrease is mainly due to decline in production base due to property disposition in early January 2003 as well as normal production decline in our existing core areas.

For the year ended December 31, 2003, net loss was $7,815,660 compared to net loss of $2,627,981 for the same period in 2002. Overall increase in loss is mainly due to ceiling test write-down required under the Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines. The Corporation reported $8,005,000 dollars in write-down during this period.

Revenues

Revenue for the twelve months ended December 31, 2003 was $5,786,791, 48% less than the $11,033,848 in the same period in 2002. The decrease is primarily due to property disposition during the year, as well as normal decline in production. Revenue per unit of production basis averaged $38.35/boe compared to $26.44/boe in 2002, up by 45%.

Hedging

Launch had a fixed natural gas contract that fixed the price on approximately 1,500 GJ per day at $4.395 expiring on April 1, 2003. Over the period of the contract, Launch incurred a net loss of $411,887. Currently, the Corporation has no hedges in place.

Commodity Prices

Year Ended December 31	2003	2002	% Change
Gas ($/mcf)	5.93	3.93	+51%
Oil and NGLs ($/bbl)	36.81	32.96	+12%

NYMEX prices during 2003 were 63% higher than in 2002. Partially offsetting this, the US$/C$ exchange rate moved from an average of $0.6371 in 2002 to $0.7164 in 2003. The effect of these changes produced an average Alberta spot price of $6.50/mcf in 2003, 64% higher than 2002's average price of C$3.96/mcf. Similarly, Launch received $5.93/mcf for its natural gas during 2003, up 51% from the average of $3.93/mcf received in 2002.

Launch's net price is after adjustments of transportation, firm toll and fee for service.

Oil and NGL sales price averaged $36.81/bbl for year ended December 31,2003, up by 12%, as compared to $32.96/bbl for year ended December 31, 2002. Gas prices are denominated in $Cdn and are benchmarked against the Western Canadian AECO-C price. This price does vary in conjunction with the $US which is our primary market. Oil prices are benchmarked against West Texas Intermediate ("WTI") in $US. As such, our prices are dependent on the underlying commodity price and on US/Cdn dollar exchange rates. During 2003, WTI averaged US $31.10/bbl, up 19% from the average US $26.13/bbl in 2002. Exchange rates between $Cdn/US have increased in favour of the $Cdn over the same period from $0.6371 in 2002 to an average of $0.7164 in 2003. The combination of these two factors resulted in Edmonton Par prices growing 8% to $43.39/bbl in 2003, from $40.20/bbl in 2002. Launch's price is net of adjustments for quality control and delivery.

The Corporation believes commodity prices during 2004 will remain strong. In comparison to 2003, Launch anticipates crude oil prices will strengthen. This conclusion is supported by a number of indicators, including OPEC's actions to date indicate a willingness to maintain prices in or above the US $28.00

range, political instability in the Middle East and strong international demand for oil, particularly in China and India.

In comparison to 2003, analyst sentiment suggests continued strength in natural gas price. Although current underground storage numbers are slightly below the five year average in comparison to inventories last year, current injections are solidly ahead. Record drilling activity in both Canada and the United States has not replaced production however, and there is a continued expectation of supply shortage for several years until such time as Northern pipelines and/or LNG supplies alleviate shortage.

Royalties

Total royalty expense, net of ARTC, decreased 47% to $993,837 in 2003 from $1,885,053 in 2002. The decrease in total royalty expense is due to 64% decrease in production. Royalties as a percentage of revenue remained relatively constant, year over year, 17% in 2003 compared to 17% in 2002. Royalty per unit of production averaged to $6.59/boe in 2003 compared to $4.52/boe in 2002. On a per unit basis, royalties have increased reflecting the impact of higher commodity price levels.

Operating Expenses

For the year ended December 31, 2003, operating costs totalled $1,505,579, down 51% from the $3,062,346 recorded in the same period ended December 31, 2002, reflecting the decreased production base. On a barrel of oil equivalent basis, operating expenses averaged $9.98 for 2003, compared to $7.34 for the same period in 2002.

Operating Netback

$/boe	2003	2002
Sales	$ 38.35	$ 26.44
Royalties	(6.71)	(4.52)
Production expense	(9.98)	(7.34)
Operating netback	$ 21.66	$ 14.58

Operating netbacks for Launch improved in 2003 by 49% compared to 2002, with higher commodity prices partially offset by increased unit royalty and operating costs.

General and Administrative Expenses

Gross general and administrative costs for 2003 were $1,590,956 ($10.54/boe) compared to $2,858,507 ($6.85/boe) for the same period in 2002, directly reflective of the decreases in production base and decreased operations from which costs have been recovered. Significant costs have also been incurred in restructuring the Corporation's affairs and in re-listing the Corporation's stock ($236,776).

The total costs are further reduced by charges allocated to the Corporation's capital and operating projects. For the entire year in 2003, recoveries totalled $257,784 compared to $71,497 in 2002. In addition, Launch capitalizes those direct costs incurred by exploration-focused personnel. During the year, Launch capitalized $228,141 compared to $468,600 in 2002.

Management anticipates reduction to the boe cost of the G&A as new production is brought on-stream during 2004.

Interest Expense

	2003	2002	% Change
Financing	$ 472,675	$ 709,180	-33%
Other	1,659,515	239,201	+594%
Total Interest	$ 2,132,190	$ 948,381	+125%
Per boe	$ 14.13	$ 2.27	+522%
Bank Debt	$ 5,282,800	$ 12,105,800	-56%

Total interest expense increased significantly in 2003 to $2,132,190 when compared to $948,381 in 2002. The decrease of 33% in financing cost is due primarily to a reduction in interest rates as well as lower bank debt. The increase of 594% in other financing cost is attributed to warrants ($104,318) outstanding as well as outstanding tax and interest penalties due for flow-through tax renouncement not made by the Corporation.

Capital Expenditures

Capital expenditures in 2003 of $3,275,529 were primarily spent on oil and gas exploration and development activities. In comparison, in 2002, the Corporation spent $2,664,119. In addition, during the year, property disposition amounted to $4,860,369 compared to $3,667,924 in 2002.

During 2003, Launch drilled or participated in nine wells, four at St. Anne (two net) and five at Retlaw (4.03 net). An additional well was recently drilled in Q1 2004 (net 0.05).

The Corporation has set its capital budget for 2004 at $2,200,000. The program will be funded through a combination of cash flow from operations and debt if deemed appropriate. Launch may adjust its capital budget to take advantage of opportunities as they arise. Fluctuations in commodity prices, exchange rates and/or economic conditions may require Launch to adjust its anticipated capital program.

Depreciation, Depletion and Site Restoration

$/boe	2003	2002
Depletion	$ 7,107,714	$ 6,861,348
Depreciation	54,984	50,637
Future site restoration (recovery)	(15,720)	89,434
Ceiling test	8,005,000	–
Total	$ 15,151,978	$ 7,001,419
Per Unit ($/boe)	$ 100.41	$ 16.78

Depletion, depreciation and site restoration expense for 2003 totalled $15,151,978 compared to $7,001,419 during 2002. The depletion and depreciation rate for year ended 2003 averaged $100.41/boe compared to $16.78/boe in 2002.

The Corporation had obligations from a flow-through share issue in 2001 which required an additional renouncement in 2003 of $4,433,607. The Corporation expended and renounced $2,664,953. In settle-

ment of this liability, the Corporation agreed with certain shareholders, including insiders to a cash settlement of $924,556, including interest of $268,473. Payment of this settlement was deferred and the parties agreed to include the amount in the subordinated debenture.

Asset Impairment Test

Under the new Canadian Institute of Chartered Accountants (CICA) full cost accounting guidelines AGC-16, the Corporation conducts an asset impairment test quarterly and annually whereby the carrying value of petroleum and natural gas properties is compared to estimated future cash flows from the production of proved reserves.

For December 31, 2003, the Corporation calculated the ceiling test using market prices as of May 12, 2004 based on Nymex future prices. The asset cash flows discounted at 5% were compared to the carrying value. As a result, the Corporation has an asset impairment write-down of $8,005,000.

Income and Other Taxes

The Corporation did not pay any cash income taxes during 2003. Capital taxes paid by the Corporation are in respect of the Federal Large Corporation tax. For the year ended December 31, 2003, the provision for capital taxes is $16,783. Capital tax provision for the year ended December 31, 2002 was $62,182.

During 2003, there have been substantial changes enacted to the federal and Alberta income tax rates and to deductions for resource income, reducing the rate on resource income, providing for the deduction of Crown royalties and eliminating the resource allowance over a five year period. For Launch, the expected income tax charge was reduced by the impact of approximately 4.6% drop in tax rates, a change in valuation allowance, more than offset by a flow-through share renouncement. For the year ended December 31, 2003, the provision for future income taxes was $3,531,860, with total tax pools of approximately $18,900,000.

Tax Pools

As at December 31	2003	2002
Undepreciated capital cost	$ 2,346,443	$ 3,240,784
Canadian oil and gas property	66,399	–
Canadian development expense	188,229	441,060
Canadian exploration expense	2,223,661	–
Non-capital losses	6,776,234	3,794,061
Foreign Exploration Development Expenditures (FEDE)	7,080,408	7,847,737
Share issue cost	126,000	155,415
Total tax pools	$ 18,807,374	$ 15,479,057

Liquidity and Capital Resources

At the end of the year 2002, Launch had a net debt position of $15,909,154. By December 31, 2003, Launch's bank line draw was reduced to $5,282,800 with a working capital deficit excluding bank debt of $4,296,222, or net debt of $9,579,022. The reduction in overall net indebtedness is due to property disposition during the first quarter of 2003 as well as issuance of flow-through shares at $0.20 per share and common shares at $0.15 per share during fourth quarter of 2003.

On December 10, 2003, the Corporation issued 8,893,195 flow-through common shares pursuant to a private placement offering at a price of $0.20 per share for gross proceeds of $1,778,639. The Corporation is committed to renounce $1,778,639 of Canadian Exploration Expense in 2003 to the subscribers of these shares. The Corporation has until December 31, 2004 to incur the qualifying expenditures. Based on the current forecast of operations for 2004, the Corporation is confident this obligation will be met. Additionally, the Corporation issued 830,811 common shares at $0.15 per share for gross proceeds of $124,621.

At December 31, 2003, the Corporation had 56,181,306 common shares outstanding and 1,040,000 options outstanding at an average exercise price of $0.30 per share. The Corporation also has an obligation to issue 1,300,000 warrants (see Note 8).

ACCOUNTING POLICIES

Launch's accounting policies are stated in Note 2 to the audited Financial Statements. Launch follows policies that are in accordance with Canadian generally accepted accounting policies.

Critical Accounting Estimates

Management is required to make judgements, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Corporation. The following discussion outlines the accounting policies and practices that are critical to determining Launch's financial results.

(a) Full Cost Accounting

Launch follows the Canadian Institute of Chartered Accountants guideline on full cost accounting in the oil and gas industry to account for oil and gas properties. Under this method, all costs associated with the acquisition of, exploration for and development of natural gas and crude oil reserves are capitalized and costs associated with production are expensed. The capitalized costs are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves. Reserve estimates can have a significant impact on earnings, as they are a key component in the calculation of depreciation, depletion and amortization ("DD&A"). A downward revision in a reserve estimate would result in a higher DD&A charge to earnings. In addition, if net capitalized costs are determined to be in excess of the calculated ceiling, which is based largely on reserve estimates, the excess must be written off as an expense charged against earnings. In the event of a property disposition, proceeds are normally deducted from the full cost pool without recognition of a gain or loss unless there is a change in the DD&A rate of 20 percent or greater.

(b) Oil and Gas Reserves

Launch's proved oil and gas reserves are 100 percent evaluated and reported on by an independent petroleum engineering firm. The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, estimated commodity price forecasts and the timing of future expenditures, all of which are subject to a number of uncertainties and various interpretations. These estimates are the basis for the determination of the fair market value and the estimated net revenue stream of these reserves. The Corporation expects that its estimate of reserves will change to reflect updated

information. Reserve estimates can be revised upward or downward based on the results of future drilling, testing, production levels and economics of recovery based on cash flow forecasts.

(c) Asset Impairment

The above noted forecasts are used in the determination of future net revenue (using prices in effect at the end of the year and held constant) when performing the asset impairment test which is the test undertaken to determine if the unamortized capital costs or carrying amount associated with these reserves are in excess of the future net revenue as calculated above. If the sum of the net revenue streams is less than the carrying amount, the impairment loss is charged to earnings.

(d) Future Income Taxes

The Corporation follows the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax base, using substantively enacted future income tax rates. In June 2003, the Federal Government introduced a gradual reduction in the general corporate income tax rate over a five year period starting January 1, 2003. The impact of the new legislation requires the Corporation to schedule out all existing temporary differences, identify the accounting and tax values during the five year phase-in period for the declining tax rates and recalculate the future income tax balance using tax rates in effect when temporary differences reverse. The above noted forecasts of estimated net revenue streams are utilized to calculate the future tax provision and, as such, are subject to revisions, both upwards and downwards that are not known at this time. In addition to these revisions, future capital activities can impact the timing of the reversal of any temporary differences. These differences can have an impact on the amount of future taxes determined at a point in time, and to the extent that these differences are created, they can impact the charge against earnings for future income taxes.

(e) Future Site Restoration and Abandonment Costs

The Corporation recognizes a provision for future site restoration and abandonment costs calculated on the unit-of-production basis over the life of the petroleum and natural gas properties based on total estimated proven reserves (see above) and an estimated future site restoration and abandonment facility.

The estimate of the future site restoration and abandonment liability is determined by management based on the best available information using current costs and current technology. These estimates are subject to change over time and, as such, may impact the charge against income for future site restoration and abandonment costs.

(f) Impact of New Accounting Pronouncements

In November 2002, the Accounting Standards Board amended its accounting guidelines on hedging relationships. The guideline specifies certain criteria that must be met for an item to be accounted for as a hedge. The criteria includes ensuring the hedge meets the risk management objective and strategy, the instrument must be designated as a hedge and the hedge must be effective. The guideline is effective for years beginning on or after July 1, 2003. There will potentially be more volatility in earnings as a result of the adoption of this guideline. Launch does not currently have any hedges; hence the guideline has no current applicability. Launch currently cannot reasonably estimate the effect the policy would have.

In December 2002, the CICA approved Section 3110, "Asset Retirement Obligations". The new guidance requires liability recognition for retirement obligations associated with the Corporation's property and equipment. These obligations are initially measured at fair value, which is the discounted future value of the liability. This fair value is capitalized as part of the cost of the related asset and amortized to expense over its useful life. Accretion is recorded until the Corporation expects to settle the retirement obligation. Section 3110 is effective for fiscal years beginning on or after January 1, 2004. The total impact on the Corporation's financial statement has not yet been determined.

In September 2003, the CICA issued an amendment to section 3870, "Stock based compensation and other stock based payments". The amended section is effective for fiscal years beginning on or after January 1, 2004, however, earlier adoption is recommended. The amendment requires that companies measure all stock based payments using the fair value method of accounting and recognize the compensation expense in their financial statements. The Corporation implemented this amended standard in 2003 in accordance with the early adoption provisions. Early adoption requires that compensation expense be calculated and recorded in the income statement for options issued on or after January 1, 2003. Prior to the implementation of this standard, only pro-forma disclosure of this impact was required. The adoption of this policy had no effect on the financial statements as no stock options were granted during the year.

In September 2003, the CICA issued Accounting Guideline 16, "Oil and Gas Accounting – Full Cost". The new guideline modifies how the ceiling test is performed, requiring that cost centres be treated for recoverability using undiscounted future cash flows which are determined by using forward indexed prices applied to proved reserves. When the carrying amount of a cost centre is not recoverable, the cost centre would be written down to its fair value. Fair value is estimated using accepted present value techniques which incorporate risks and other uncertainties as well as the future value of proved and probable reserves when determining expected cash flow. The Corporation is currently using these requirements to calculate the asset impairment test for 2003, and to ensure future compliance with this guideline.

The following standards or revisions issued by the CICA do not currently impact Launch:

- Accounting Guideline 14, "Disclosure of Guarantees", effective for fiscal periods beginning on or after January 1, 2003.
- Accounting Guideline 15, "Consolidation of Variable Interest Entities", effective for fiscal periods beginning on or after January 1, 2004.
- Section 3860, "Financial Instruments – Disclosure and Presentation", effective for fiscal periods beginning on or after November 1, 2004.
- Section 1100, "Generally Accepted Accounting Principles", effective for fiscal periods on or after October 1, 2003 on a prospective basis.
- Section 1400, "General Standards of Financial Statement Presentation", effective for fiscal periods on or after October 1, 2003 on a prospective basis.

BUSINESS RISKS

The energy industry is subject to numerous risks that are often beyond the control of oil and gas exploration and production companies. Some of the inherent risks affecting Launch's business include commodity price volatility, the uncertainty of finding economic quantities of hydrocarbon, access to land, access to third party pipelines and processing facilities, market conditions such as supply and demand, foreign benchmark pricing, government regulations and safety and environmental concerns, among others. Launch manages these risks by retaining a highly qualified and experienced staff of professionals to direct its activities, by conducting thorough geological and engineering analysis in its focus areas to maximize the potential for success, by maintaining high working interests in all properties, by maintaining the financial flexibility required to respond to new opportunities and prevailing market conditions and by ensuring appropriate liability insurance coverage.

Management's Report

Management is responsible for the integrity and objectivity of the information contained in this annual report and for the consistency between the financial statements and other financial operating data contained elsewhere in the report. The accompanying financial statements have been reviewed by management and have been prepared in accordance with Canadian generally accepted accounting principles using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The financial statements have been prepared using policies and procedures established by management and reflect fairly the Corporation's financial condition and results of operations, within reasonable limits of materiality and within the framework of the accounting policies outlined in the notes to the financial statements.

Management has established and maintains a system of internal control, which is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, that transactions are properly authorized and that financial information is reliable and accurate. Management recognizes its responsibility for conducting the Corporation's affairs in compliance with established financial standards and applicable laws and maintains proper standards of conduct of its activities.

The financial statements have been examined by external auditors. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and the financial condition of the Corporation.

The Audit Committee of the Board of Directors has reviewed in detail the financial statements with management and external auditors. The financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

John L. Burlington, M.Sc.
President and Chief Executive Officer
May 19, 2004

Shelina Hirji, CMA
Vice-President, Finance
May 19, 2004

Auditors' Report

To the Shareholders of Launch Resources Inc.:

We have audited the balance sheet of Launch Resources Inc. as at December 31, 2003 and the statements of loss and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2003 and the results of its operations and the changes in its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at and for the year ended December 31, 2002 were audited by other auditors, who expressed an opinion without reservation on these statements in their report dated March 14, 2003.

Meyers Norris Penny LLP

Chartered Accountants

Calgary, Alberta
April 27, 2004

Balance Sheet

As at December 31	2003	2002
	$	$
ASSETS		
Current		
Cash	–	336,648
Accounts receivable	1,569,357	1,715,289
Prepaid expenses	70,658	210,484
	1,640,015	2,262,421
Property and equipment (Note 4)	20,530,982	37,206,081
	22,170,997	39,468,502
LIABILITIES		
Current		
Bank indebtedness	35,815	–
Accounts payable and accruals	5,900,422	5,685,775
Bank debt (Note 5)	5,282,800	12,105,800
Loans payable (Note 6)	–	380,000
	11,219,037	18,171,575
Debenture payable (Note 7)	4,516,040	1,350,000
Provision for site restoration	499,241	698,254
Future income taxes (Note 9)	5,410,667	12,030,927
	21,644,985	32,250,756
SHAREHOLDERS' EQUITY		
Share capital (Note 8)	37,513,425	36,389,499
Deficit	(36,987,413)	(29,171,753)
	526,012	7,217,746
	22,170,997	39,468,502

Basis of presentation (Note 1)
Commitments and contingences (Note 11)

See accompanying notes to financial statements

Approved on behalf of the Board:

John Welton
Chairman, Director

James Crawford
Secretary

Statement of Loss and Deficit

For the years ended December 31	2003	2002
	$	$
REVENUE		
Petroleum and natural gas sales	5,786,791	11,033,848
Royalties, net of Alberta Royalty Tax Credit	(993,837)	(1,885,053)
Interest	54,071	41,378
Other	40,647	2,679
	4,887,672	9,192,852
EXPENSES		
Operating	1,505,578	3,062,346
General and administrative	1,590,956	2,858,505
Loss on disposition of property and equipment	–	668,000
Interest	2,132,190	948,381
Depletion, depreciation and site restoration (Note 4)	15,151,978	7,001,419
	20,380,702	14,538,651
Loss before income taxes	(15,493,030)	(5,345,799)
Income taxes		
Capital tax expense	(29,924)	(62,182)
Current income tax recovery	–	–
Future income tax recovery (Note 9)	7,707,294	2,780,000
	7,677,370	2,717,818
Net loss	(7,815,660)	(2,627,981)
Deficit, beginning of year	(29,171,753)	(26,543,772)
Deficit, end of year	(36,987,413)	(29,171,753)
Loss per share		
Basic (Note 8)	(0.17)	(0.06)

See accompanying notes to financial statements

Statement of Cash Flows

For the years ended December 31	2003	2002
	$	$
CASH FLOWS FROM THE FOLLOWING ACTIVITIES:		
Operating		
Net loss	(7,815,660)	(2,627,981)
Add items not requiring cash:		
Depletion, depreciation and site restoration	15,151,978	7,001,419
Future tax recovery	(7,707,294)	(2,780,000)
Loss on disposition of assets	–	668,000
Interest accrued (Note 7)	1,830,024	239,200
	1,459,048	2,500,638
Net increase (decrease) in non-cash working capital balances	380,388	(1,177,413)
Cash provided by operating activities	1,839,436	1,323,225
Financing		
Proceeds on issuance of common shares	124,622	21,000
Net proceeds from flow-through shares	1,778,639	–
Share issue costs	–	(9,731)
Proceeds from debenture payable	1,105,000	1,350,000
Proceeds from loans payable	18,000	755,000
Repayment of debenture and short term loans payable	–	(375,000)
Repayment of bank debt	(6,823,000)	(3,554,200)
	(3,796,739)	(1,812,931)
Investing		
Purchases and expenditures of property and equipment	(3,275,529)	(2,664,119)
Disposal of property and equipment	4,860,369	3,667,924
	1,584,840	1,003,805
Increase (decrease) in cash	(372,463)	514,099
Cash (bank indebtedness), beginning of year	336,648	(177,451)
Cash (bank indebtedness), end of year	(35,815)	336,648

See accompanying notes to financial statements

Notes to Financial Statements

For the years ended December 31, 2003 and 2002

1. BASIS OF PRESENTATION

The Corporation is incorporated under the laws of Alberta and its primary business is the acquisition of, exploration for, and development and production of crude oil and natural gas in Western Canada.

On January 1, 2001 Launch Resources Inc. (formerly Kicking Horse Resources Ltd.) acquired all P&NG assets of its wholly owned subsidiaries Warburg Resources Ltd. and Comrey Resources Inc. At April 1, 2001, PRL Resources Inc., a wholly owned subsidiary, was amalgamated into Kicking Horse Resources Ltd. ("the Corporation"). On June 16, 2003, Woodbend Resources Corp., a wholly owned inactive subsidiary, was amalgamated into the Corporation.

Pursuant to a special resolution passed by shareholders August 29, 2003, the Corporation has changed its name from Kicking Horse Resources Ltd. to Launch Resources Inc. Effective March 8, 2004, the common shares of Launch Resources Inc. ("LAU") commenced trading on the TSX Venture Exchange, and the common shares of Kicking Horse Resources Ltd. were delisted.

Going concern

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a "going concern" basis, which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. The Corporation has experienced significant losses in the years ended December 31, 2003 and 2002, has a $9,579,022 (2002 – $15,909,154) working capital deficiency and is in violation of certain financial debt covenants as at December 31, 2003. If the "going concern" basis was not appropriate for these financial statements, then significant adjustments would be necessary to the carrying value of the assets and liabilities, the reported revenue and expenses and the balance sheet classifications used. The appropriateness of the "going concern" assumption is dependent upon, among other things, the Corporation's ability to continue to generate sufficient cash flow from its existing operations, obtain equity financing or continue to divest its properties in order to reduce its debt load. The outcome of these matters cannot be predicted at this time. These financial statements do not contain any adjustments to the amounts and classification of assets and liabilities that may be necessary should the Corporation be unable to continue business.

2. ACCOUNTING POLICIES

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies.

Property and equipment

(i) Petroleum and natural gas properties and facilities and equipment

The Corporation follows the full cost method of accounting for petroleum and natural gas properties whereby all costs related to the acquisition of, exploration for, and development of petroleum and natural gas properties and related reserves are capitalized. Such costs include lease acquisition, drilling, geological and geophysical costs and administrative expenditures directly related to acquisition, exploration and development activities. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets, except when such a disposal would change the depletion and depreciation rates by more than 20%, in which case a gain or loss on disposal would be recorded.

Capitalized costs, including tangible production equipment, are depleted and depreciated using the unit of production method based on estimated proven reserves of petroleum and natural gas before royalties, as determined by independent reserve engineers, converting natural gas to an oil equivalent basis using six thousand cubic feet of natural gas for one barrel of petroleum. Costs of acquiring and evaluating unproven properties are excluded from depletion calculations until it is determined whether or not proven reserves are attributable to the properties or impairment occurs.

Impairment test

In applying the full cost method, the Corporation calculates a ceiling test for each cost centre whereby the carrying value of property and equipment is compared at each reporting period to the sum of the undiscounted cash flows expected to result from the future production of proved reserves and the sale of unproved properties. Cash flows are estimated using third party quoted forward prices, adjusted for transportation and quality, less estimated costs directly associated with the development, production and sale of reserves. Should the ceiling test result in an excess of carrying value, the Corporation would then measure the amount of impairment for the cost centre by comparing the carrying amounts of property and equipment to an amount equal to the estimated net present value of future cash flows from proved plus probable reserves and the sale of unproved properties. A risk-free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying amount would be recorded as a permanent impairment.

(ii) Office equipment

The Corporation records office equipment at cost and provides depreciation on the declining balance method at rates varying from 20% to 30% per annum which is designed to amortize the cost of the assets over their estimated useful lives.

Joint activities

Substantially all of the Corporation's exploration and production activities are conducted jointly with others and accordingly, these financial statements reflect only the Corporation's proportionate interest in such activities.

Site restoration

Estimated future costs of site restorations, including the removal of production facilities at the end of their useful lives, are provided for on a unit of production basis. The estimate is based on current costs, existing legislation and industry practice. The annual provision is included in the depletion, depreciation and site restoration expense account as incurred. Actual expenditures incurred are applied against the accumulated liability.

Derivative financial instruments

Derivative financial instruments are utilized to reduce commodity price risk for the Corporation's production of oil and natural gas. The base prices for the commodities are sometimes denominated in United States dollars and the Corporation may also use such financial instruments to reduce the related foreign currency risk. The Corporation does not enter into financial instruments for trading or speculative purposes.

The Corporation has historically used hedge instruments such as forward sales in amounts up to a maximum of 50 percent of non-aggregated sales of oil and natural gas during the term of the instruments. The objective is to partially offset or mitigate the wide price swings commonly encountered in these commodities. The Corporation's policy is to designate each derivative financial instrument employed as a hedge of a specific portion of projected production over the term of the instrument. The instruments employed may be denominated in United States or Canadian dollars. The Corporation believes the derivative financial instruments used are effective as hedges over their term.

In the case of forward sales, the instrument can sometimes be satisfied by physical delivery. In all other cases the instrument is satisfied by payments or charges calculated by referring published prices to the agreed reference price in the terms and manner set out in the contract and paid or received monthly. In the case of physical delivery, the payment is part of the normal revenue stream and all other payments or charges are accounted for monthly as adjustments to revenue received.

Earnings per share

The Corporation calculates basic earnings per share using the weighted average number of shares outstanding during the year. The Corporation follows the treasury stock method for the computation and disclosure of diluted per share amounts. Under this method, the diluted weighted average number of common shares outstanding is calculated by assuming proceeds from the exercise of dilutive ("in the money") options are used to purchase common shares at the average market price.

Flow-through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Under the liability method of accounting for income taxes the tax effect of the flow-through shares is recorded when the related expenditures are incurred.

Income taxes

The Corporation utilizes the asset and liability method of accounting for income taxes. Under this method, future income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases using tax rates that are expected to be in effect when the related income and expense items are expected to be realized. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period that the change occurs. In addition, the future benefits of income tax assets, including unused tax losses are recognized, subject to a valuation allowance, to the extent that it is more likely than not that such future benefits will ultimately be realized.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accounts receivable are stated after evaluation as to their collectibility and an appropriate allowance for doubtful accounts is provided where considered necessary. The amounts recorded for depletion of property and equipment and the provisions for future abandonment and site restoration costs are based on estimates. The ceiling test is based on such factors as estimated proven reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of future periods could be material if actual results differ from these estimates.

3. CHANGE IN ACCOUNTING POLICY

Stock-based compensation

In November 2003, the CICA revised Handbook Section 3870, *Stock-based Compensation and other Stock-based Payments*, with respect to the accounting for stock-based compensation and other stock-based payments. The revised recommendations require that beginning January 1, 2004, the fair value-based method be used to account for all transactions whereby goods and services are received in exchange for stock-based

compensation and other stock-based payments. Under the fair value-based method, compensation costs are measured at fair value at the date of grant and are expensed over the award's vesting periods.

In accordance with one of the transitional options permitted under Section 3870, the Corporation has elected to early adopt the new recommendations effective January 1, 2003 and prospectively apply the standard for employee stock awards granted after January 1, 2003. Prior to the adoption of the fair value-based method, the Corporation, as permitted by Section 3870, had chosen to continue its existing policy of recording no compensation cost on the grant of stock options to employees. The adoption of this policy had no effect on the financial statements as no stock options were granted during the year.

4. PROPERTY AND EQUIPMENT

		2003	
	Cost	Accumulated Depletion and Depreciation	Net Book Value
	$	$	$
Petroleum and natural gas properties	49,250,086	29,741,328	19,508,758
Facilities and equipment	3,325,817	2,414,018	911,799
Office equipment	271,367	160,942	110,425
	52,847,270	32,316,288	20,530,982

		2002	
	Cost	Accumulated Depletion and Depreciation	Net Book Value
	$	$	$
Petroleum and natural gas properties	50,269,754	15,731,645	34,538,109
Facilities and equipment	3,663,038	1,146,328	2,516,710
Office equipment	238,586	87,324	151,262
	54,171,378	16,965,297	37,206,081

The Corporation capitalized $228,141 (2002 – $468,600) of general and administration expenses during the year. Included in accounts payable and accruals is $260,732 (2002 – $32,286) of property and equipment purchases.

In conducting the ceiling test as at December 31, 2003, the Corporation's estimated future cash flow from proven and probable reserves was less than the carrying value of the related property and equipment and hence a write-down of $8,005,000 was taken and is included in "depletion, depreciation and site restoration". The ceiling test used the following future commodity price assumptions, adjusted for quality and estimated transportation costs pertaining to the following:

Natural Gas – Canada (1) natural gas price using Alberta Gross Reference Price
Crude Oil – Canada (2) crude oil refinery postings at Edmonton par

	2004	2005	2006	2007	2008	2009	2010
Natural Gas ($/mcf) Canada	6.83	6.58	6.04	5.77	5.63	5.54	5.58
Launch Price ($/mcf)	7.07	6.88	6.33	6.07	5.93	5.84	6.02
Crude Oil ($/bbl) Canada	50.38	46.01	42.37	39.39	38.26	37.39	37.19
Launch Price ($/bbl)	36.62	35.57	32.55	30.13	29.04	28.40	28.05

2011 + escalate prices at 1.5 percent per year

(1) adjusted with $0.61 adjustment for currency and unit adjustment

(2) oil price adjusted for currency exchange (US $0.75) and per barrel marketing fee (US $0.50)

5. BANK DEBT

The Corporation has a demand revolving/reducing loan with a maximum available credit of $5,282,800 (2002 – $12,105,800) bearing interest at the bank's prime rate plus 1% and repayable in monthly principal payments of $325,000. The Corporation has pledged all of its assets as collateral for loans under the facility. The credit facility is secured by a general security agreement covering all present and future property and a first fixed and floating charge debenture with a fixed charge over the property. The terms of the Corporation's bank facility include certain financial statement covenants. At December 31, 2003, the Corporation was in violation of certain of those covenants. Accordingly, the bank, although it has not done so, is entitled to demand immediate repayment of all loans under this facility.

Subsequent to year-end the Corporation has renegotiated the demand revolving loan to a maximum of $4,400,000. Effective April 26, 2004 the principal payments were reduced from $325,000 per month to $150,000 for a three month period. Thereafter, principal payments will be $200,000 per month.

Scheduled loan repayments over the next three years, assuming the bank does not exercise its rights to immediate repayment, are as follows:

	$
2004	2,625,000
2005	2,400,000
2006	257,800
	5,282,800

6. LOANS PAYABLE

Short term loans were payable to a director and shareholders of the Corporation and were unsecured, bore interest at 8%, and were due on demand. As part of the negotiation involving debenture agreement (Note 7), this loan was added to the principal balance of the subordinated debenture.

7. DEBENTURE PAYABLE

At January 1, 2003, the Corporation had $1,350,000 of 8% unsecured debenture payable. The debenture is held by Johwel Investments Inc. One of the Corporation's directors, John Welton, is a director of Johwel. On May 14, 2003, the Corporation amended this previously issued debenture to provide collateral security and issued an additional $1,105,000 of 8% secured debenture which is due September 30, 2004. The Corporation has pledged certain assets as collateral. In conjunction with this transaction, the Corporation is committed to issuing up to a maximum of 1,300,000 warrants to purchase common shares (Note 8). The Corporation records additional interest expense and share capital based on the fair value of the warrants at the time the warrants are issued. The Corporation uses the Black-Scholes option pricing model to determine the warrants' fair value.

Subsequent to year-end, the Corporation further amended the previously amended and restated debenture to a maximum of $6,000,000. In conjunction with the increase in the debenture, the Corporation has reached an agreement with a number of its creditors, including some insiders, to restate their short-term, unsecured debt and accept longer term debt. The Corporation has also reached an agreement with certain 2001 flow-through shareholders to indemnify the shareholders for renouncements not made by the Corporation, specifically the tax portion and accrued interest. A total of $1,580,314 including $1,555,198 in interest has been accrued as debenture payable as at December 31, 2003.

The debenture is redeemable prior to the date of maturity at the option of the Corporation at a price equal to the outstanding principal plus accrued interest. The debenture bears interest at 14% on funds advanced prior to April 1, 2004 and 20% on funds advanced following April 1, 2004.

Balance outstanding, December 31, 2002	1,350,000
Flow-through share interest and penalties	1,555,198
Loans payable converted to debenture (Note 6)	398,000
Additional debenture issued	1,105,000
Deferred interest charge on warrants (Note 8)	(125,182)
Accounts payable and accruals converted to debenture	207,908
Other	25,116
Balance outstanding, December 31, 2003	**4,516,040**

8. SHARE CAPITAL

Authorized

Unlimited number of voting common shares; no par value

Issued and issuable

	2003		2002	
	Number of Shares	**Amount $**	Number of Shares	Amount $
Common shares				
Balance outstanding, beginning of year	**46,457,300**	**36,150,299**	46,422,300	36,925,030
Issued pursuant to flow-through share offering (i)	**8,893,195**	**1,778,639**	–	–
Tax benefits renounced (ii)	–	**(1,087,035)**	–	(786,000)
Issued for cash pursuant to private placement (iii)	**830,811**	**124,622**	35,000	21,000
Share issue costs, net of tax	–	–	–	(9,731)
Balance outstanding, end of year	**56,181,306**	**36,966,525**	46,457,300	36,150,299
Warrants				
Balance outstanding, beginning of year	**330,000**	**239,200**	–	–
Cancelled May 14, 2003	**(330,000)**	**(239,200)**	–	–
Warrants issued	**1,300,000**	**546,900**	330,000	239,200
Balance outstanding, end of year	**1,300,000**	**546,900**	330,000	239,200
Shares and warrants outstanding, end of year	**57,481,306**	**37,513,425**	46,787,300	36,389,499

(i) During 2003, the Corporation issued 8,893,195 flow-through common shares under a private placement of $0.20 per share for gross proceeds of $1,778,639, of which $1,625,000 was received in cash and the remaining balance of $153,639 is included in accounts receivable at year-end.

(ii) During the year, the Corporation incurred exploration and development expenditures of $2,664,953 (2002 – $1,800,000) previously renounced for income tax purposes.

(iii) During 2003, the Corporation issued 830,811 common shares under a private placement of $0.15 per share for gross proceeds of $124,622.

Warrants

At January 1, 2003, the Corporation had an outstanding commitment to issue 330,000 warrants in connection with its debenture payable (see Note 7). These warrants were to be exercisable into 330,000 common shares at $0.70 per share. On May 14, 2003, the Corporation amended this previously issued debenture and issued an additional $1,105,000 of secured debenture which is due on September 30, 2004. In conjunction with this transaction, the Corporation cancelled the previous obligation to issue warrants and is committed to issue up to a total of 1,300,000 warrants to purchase common shares, subject to regulatory approval, representing additional compensation to the holder. This has resulted in

an offsetting charge of $229,500 being recorded against the debenture payable balance to reflect the fair value of the liability resulting from this commitment and is being amortized over the term of the agreement as interest expense and an increase in the payable balance. During the year ended December 31, 2003, $104,318 of interest expense was recognized resulting in an ending deferred charge balance of $125,182. Each warrant issued under the debenture payable will have an exercise price of $0.15, market price of the Corporation's common shares, and is exercisable until May 15, 2005. None of these warrants have been exercised as at December 31, 2003.

Options

The Corporation has established a stock option plan whereby options may be granted to the Corporation's directors, officers and employees for up to 10% of the Corporation's issued and outstanding common shares. The exercise price of each option equals the market price of the Corporation's common shares on the date of the grant and the vesting and expiry terms are set by the Corporation's board of directors. The following summarizes information with respect to stock options outstanding:

	2003		2002	
	Options	**Weighted Average Exercise Price $**	Options	Weighted Average Exercise Price $
Outstanding at beginning of year	**1,040,000**	**.30**	2,158,684	.31
Expired	–	–	1,118,684	.30
Outstanding at end of year	**1,040,000**	**.30**	1,040,000	.30
Exercisable, end of year	**1,040,000**	**.30**	1,040,000	.30

The following summarizes information about stock options outstanding at December 31, 2003:

Exercise Prices $	Number outstanding and exercisable at December 31, 2003	Weighted Average Remaining Contractual Life (years)
0.26	565,000	2.25
0.30	250,000	1.94
0.40	225,000	1.00
	1,040,000	

Weighted average number of common shares

	2003	2002
Basic weighted average number of common shares outstanding	**46,941,551**	46,454,383

Any potential exercise of the Corporation's options would be anti-dilutive.

9. FUTURE INCOME TAXES

The Corporation has an effective tax rate which differs from the expected Canadian income tax rate. The differences are as follows:

	2003	2002
Statutory tax rate	40.79%	42.12%
Computed expected tax recovery	(6,319,607)	(2,251,651)
Increase (decrease) resulting from:		
Crown charges, net of ARTC	238,197	754,530
Resource allowance	(98,318)	(694,069)
Benefit of assets not previously recognized	(323,940)	(450,272)
Rate adjustment	(1,905,248)	(157,770)
Non-deductible interest and penalties	695,791	–
Other	5,831	19,232
Future income tax recovery	(7,707,294)	(2,780,000)

As at December 31, 2003, the Corporation has non-capital losses of approximately $6,776,000 available to reduce future years' taxable income. These non-capital losses expire as follows:

2006	715,375
2010	6,060,625
	6,776,000

In addition the Corporation has exploration and development costs, foreign exploration and development costs, undepreciated capital costs, cumulative eligible capital and unamortized share issue costs available for deduction against future taxable income of approximately $12,100,000 (2002 – $22,798,000). The future income tax benefit of the non-capital losses and foreign exploration and development costs have not been recognized.

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. The components of the Corporation's future income tax assets and liabilities are as follows:

	2003	2002
Future tax assets		
Future site restoration	187,315	220,578
Share issue costs	47,197	71,461
Loss carryforwards	3,017,188	1,598,058
Attributed Canadian royalty income carryforward	231,651	220,913
Other	39,378	281,641
Valuation allowance	(3,017,188)	–
	505,541	2,392,651
Future tax liability		
Net book value of property and equipment in excess of tax basis	2,520,307	6,475,124
Valuation allowance	3,395,901	7,948,454
	5,916,208	14,423,578
Net future tax liability	5,410,667	12,030,927

10. FINANCIAL INSTRUMENTS

The Corporation, as part of its operations, carries a number of financial instruments. It is management's opinion that the Corporation is not exposed to significant interest (except on its bank loans), or currency risk arising from these financial instruments.

Fair value

The fair value of the Corporation's accounts receivable, bank indebtedness and accounts payable and accruals approximate their carrying value due to the short-term nature of these instruments. The carrying values of the Corporation's bank debt and loans payable approximate their fair values because interest charges under the terms of the debt are based upon current Canadian bank prime rates.

It is not practical within the constraints of timeliness or cost to determine the fair value of the debenture payable because this instrument is not traded in an organized financial market.

Fair values are based on management's best estimate after consideration of current market conditions. The estimates are subjective and involve considerable judgment, and as such are not necessarily indicative of the amounts that the Corporation may incur in actual market transactions.

Credit risk

Virtually all of the Corporation's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

Derivative instruments

During the year, the Corporation entered into a fixed price contract to sell approximately 1,500 GJ per day of natural gas at a fixed price of $4.395, which expired April 1, 2003. For the year ended December 31, 2003, the Corporation realized a net loss of $411,887 on its natural gas risk management. As at December 31, 2003 there were no contracts in effect.

11. COMMITMENTS AND CONTINGENCIES

The Corporation committed to an office lease until 2006 requiring annual payments of:

2004	$ 109,000
2005	$ 117,000
2006	$ 117,000

Effective October 1, 2003, the Corporation subleased approximately 3,000 square feet for the remainder of the lease term. Annualized payments are to be credited to the Corporation to reduce the commitment by $54,000 in 2004, $55,800 in 2005 and $58,200 in 2006.

The Corporation has been named as defendant in two lawsuits on behalf of third parties, seeking to recover damages allegedly sustained by them as a result of business transactions. These lawsuits remain at an early stage and, as litigation is subject to many uncertainties, it is not possible to predict the ultimate outcome of these lawsuits or to estimate the loss, if any, which may result.

Corporate Information

DIRECTORS
W.T. David Murray (1) (2) (3)
John W. Welton (1) (2)
James C. Crawford (3)
Murray J. Berg (2) (3)
Sidney Dick (1)

OFFICERS & KEY PERSONNEL
John L. Burlington, M.Sc. (3)
President and C.E.O.

Wing-Kee Chan
Vice-President, Engineering and C.O.O.

Shelina Hirji, CMA
Vice-President, Finance

Cheryl A. Barclay
Senior Accountant

Julie Barclay
General Accountant

Suzanne Molofy
Office Administrator

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(2) Member of the Compensation Committee
(3) Member of the Reserves Committee

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ABBREVIATIONS

bbls	barrels
mbbls	thousands of barrels
bopd	barrels of oil per day
boe	barrels of oil equivalent
boed	barrels of oil equivalent per day
mboe	thousand barrels of oil equivalent
mmboe	million barrels of oil equivalent
WTI	West Texas Intermediate
mcf	thousand cubic feet
mmcf	million cubic feet
mcf/d	thousand cubic feet per day

Units of natural gas have been converted into barrel of oil equivalents at a ratio of six thousand cubic feet of gas to one barrel of oil. Boe's may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf : 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

CONVERSION
The following table sets forth certain standard conversions from Standard Imperial Units to the International System of Units (or metric units).

To Convert From	To	Multiply by
mcf	cubic metres (m^3)	28.174
cubic metres (m^3)	cubic feet	35.494
bbls	cubic metres	0.159
cubic metres (m^3)	bbls	6.290
feet	metres	0.305
metres	feet	3.281
miles	kilometres	1.609
kilometres	miles	0.621
acres	hectares	0.405
hectares	acres	2.471

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